Abstract
Governments try to attract firms and jobs by investing in international infrastructure. We analyse this type of strategic policy competition in a three-country model of monopolistic competition.
What governments compete for, is to obtain a so called 'hub' position. A hub is a relatively well connected location in a transport network. A hub might thus be an attractive location for firms. However, for a small or backward country the hub position, due to infrastructure investment, is overwhelmed by the disadvantage of a small home-market. As investment to become a hub triggers an investment response from other countries, a backward country is unlikely to keep its relatively attractive position. An attractive location is only sustainable if investment applies to point infrastructure and builds upon a natural advantage (e.g. an harbour).
The game of action and reaction delivers socially undesirably high levels of infrastructure investment if transport costs are already low and firm mobility is high.